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Report No. P-232

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATIONS OF THE PRESIDENT TO THE EXECUTIVE DIRECTORS ON A PROPOSED LOAN TO ISRAEL FOR A PORT PROJECT

August 25, 1960

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1. I submit herewith the following report and recommendations on a proposed loan to the State of Israel in an amount in various currencies equivalent to $27.5 million to assist in the financing of the construction of a new port at Ashdod.

PART I - HISTORICAL

2. The State of Israel came into being in 1948 on the termination of the British Mandate over Palestine. Fighting followed the withdrawal of the British. Armistice Lines were fixed in 1949 under agreements between Israel and each of the neighboring States. Since then these have remained the borders of Israel. Israel became a member of the Bank in July 1954 and this would be the Bank's first loan to Israel. A Bank Mission visited Israel in April 1959 to assess the economic situation, and another Bank Mission in March and April of this year to appraise the port project. Negotiations on the proposed loan began in Washington on July 20 and were completed on August 10. The following Israeli officials took part in the negotiations: Mr. David Horowitz, Governor of the Bank of Israel, Mr. David Kochav, Director of the Research Department, Bank of Israel, Dr. Y. Arnon, Director General, Ministry of Finance, Mr. Shaul Bar-Zeev, Director, Shipping and Ports Division, Ministry of Transport and Communications, Mr. Aryeh Manor, Economic Minister, Embassy of Israel, and Mr. Avraham Salmon, Economic Counselor, Embassy of Israel.

PART II - DESCRIPTION OF THE PROPOSED LOAN

3. The main characteristics of the Loan are as follows:

Borrower	:	State of Israel
Amount	:	An amount in various currencies equivalent to $27.5 million
Purpose	:	The proceeds of the proposed loan will be used to assist in financing the first phase of the construction of a new sheltered deep-water port on the Mediterranean at Ashdod.

Interest Rate	:	5.3/4% per annum, including 1% commission
Term	:	25 years, including a grace period of 5 years
Amortization	:	41 semi-annual payments beginning August 15, 1965 and ending August 15, 1985
Commitment Charge	:	3/4 of 1% per annum
Special Condition	:	The establishment of a self-sustaining Port Authority to be responsible for the construction, operation and development of port facilities in Israel
Special Payment Arrangements	:	Arrangements will be made for payment of debt service from the foreign exchange revenues of the Port Authority.

4. The total cost of the project is estimated at $54.7 million. Because of the availability within Israel of capital goods, the foreign exchange required will amount to only about $18 million, and about $9.5 million of the Bank's loan would be used to cover expenditures incurred in local currency. Since its beginning in 1948, the State of Israel, without the benefit of rich natural resources, has attained a remarkable rate of economic growth and industrial development and now manufactures a wide range of capital goods. To finance its development it has obtained, in addition to the savings available at home, massive help from abroad, notably in the form of contributions from foreign Jews and reparations and restitution payments from Germany. The Israeli Government is now engaged in a five-year investment program well suited to the special conditions of development in Israel. Although the economy is now beginning to generate savings of significant size, it still depends heavily on the continued import of capital. In these circumstances the expenditure of about one third of the loan in local currency appears justified. The balance of the local currency costs of $27.2 million will be financed by the Government from current port operations and by appropriations from the development budget.

PART III - LEGAL INSTRUMENTS AND LEGAL AUTHORITY

5. Attached are drafts of a Loan Agreement (No.1) and the report of the committee provided for in Article III, Section 4(iii) of the Articles of Agreement (No.2). The draft Loan Agreement follows the form generally

used by the Bank, with the following additions:

(a) Section 5.08 provides that the Borrower will make arrangements satisfactory to the Bank to set aside sufficient of the port revenues received in foreign currency by all Israeli ports to cover the debt service falling due each half year. The making of these arrangements would be a condition of effectiveness of the Loan Agreement under Sections 7.01 and 7.02 of the draft Loan Agreement. Draft Letters setting forth these arrangements are attached (Nos. 3, 4 and 5).

(b) The above arrangements would not in any way diminish the general obligations of the Borrower to pay the debt service on the loan (see Section 2.08 of the draft Loan Agreement).

(c) In Section 5.09 of the draft Loan Agreement the Borrower undertakes to establish a self-sustaining Port Authority responsible for the construction, operation and development of port facilities in Israel.

(d) In Section 2.02 the Borrower is limited to withdrawal of not more than the equivalent of $2 million until it has established the Port Authority.

(e) Section 6.02 of the draft Loan Agreement makes it an event of default if the Port Authority has not been established by April 1, 1961.

(f) Paragraph (d) of Schedule 3 provides inter alia for the withdrawal of the loan proceeds on account of local expenditures at rates and in amounts to be agreed upon from time to time between the Borrower and the Bank.

(g) Paragraph (b) of Schedule 3 provides that withdrawals on account of local currency expenditures may be made in any convertible currency selected by the Bank.

PART IV - APPRAISAL OF THE PROPOSED LOAN

6. A detailed appraisal of the Israel Port Development Project (T.O.250b, dated August 25, 1960) is attached (No.6).

Justification of the Project

7. Except for Haifa in the north, there are no natural harbors on Israel's Mediterranean coast. Haifa's facilities are already overburdened and it now handles about 2,400,000 tons per annum, or 85% of Israel's sea-

borne trade. Because the port is surrounded by the town of Haifa it cannot be easily expanded. The only other Mediterranean ports of Israel are the open roadsteads of Tel Aviv and Jaffa, access to which is through Israel's most densely populated areas. In view of the large increases in exports and imports expected in future years, the Government decided to construct an entirely new sheltered deep-water port in the south. After careful study the new port site was located at Ashdod.

8. The construction of the Port of Ashdod would be in two phases. The first phase, which is the present project, consists of the construction of wharves and other facilities sufficient to accommodate five ships at one time. It includes a breakwater which accounts for about half the cost of construction. Inside the breakwater other wharves can be constructed at a later date and this is the second phase. Its construction would start when the first phase is completed in 1965, should the traffic growth justify it.

9. Port expansion seems amply justified. New citrus groves have already been planted which, when they mature, will be bearing more fruit than existing ports could handle. The Government plans to make Ashdod the center of a new industrial area which will need port facilities. Planned expansion of potash and phosphate production in the Negev is predicated on the port expansion and obviously Ashdod, by its proximity, offers much greater advantages to shippers from the Negev than expansion in the north. Dry cargo traffic through Mediterranean ports is estimated to grow from 2,844,000 metric tons in 1959 to 4,450,000 metric tons in 1970. The start of operations at Ashdod will relieve congestion on the north/south rail and road communications of Israel. It will also permit the Israeli Government to close down the uneconomic lighterage ports of Tel Aviv and Jaffa.

10. The project is justified on economic grounds, since estimated savings on transportation and other costs at the estimated 1965/66 traffic volume would amortize the cost of the project over its useful life and give a return on the investment of about 7½% per annum. It is the intention of the Government to revise port tariffs along the lines recommended by its consultant and this will result in an improvement of the financial position of the new port. However, even before such revision, the estimated earnings of the new Port of Ashdod should be sufficient to meet the debt service on the proposed loan.

11. As pointed out in paragraph 5(c), the Israeli Government has undertaken to establish a Port Authority. As soon as established, it would take over the task of constructing the new port at Ashdod which is now under the jurisdiction of the Ministry of Transport and Communications.

Procurement

12. Major construction contracts will be awarded through international competitive bidding.

Economic Situation

13. A report on the economy of Israel was circulated to the Executive Directors on February 19, 1960 (R 60-32). It was based on the findings of the mission which visited Israel early in 1959. The mission pointed out that Israel had been able to achieve a remarkably rapid rate of economic growth and had been able to provide a rising standard of living to a rapidly expanding population. In the light of the impressive performance of past years, the mission concluded that the goals set by the Israeli authorities for development in the next five years could be met. Achievement of them would, however, require development of substantial new exports, firm control of credit, the maintenance of a balanced budget and the continuation of foreign assistance. It is now more than a year since the mission visited Israel and in nearly every aspect the Israeli Government has been able to achieve more than was then expected of it.

14. Exports of goods and services were 24% higher in value in 1959 than in 1958, and they covered 50% of imports as against only 42% in the previous year. Agricultural exports ($57 million) remained at about the same level as in 1958. Exports of diamonds ($47 million) increased 37%. Industrial exports other than diamonds ($75 million) increased by 55%. In the first five months of 1960 exports were 16% higher in value than in the same period of 1959. Foreign exchange reserves have also grown. In the year ending March 1960 they increased by $60 million to $205 million, well on the way to the Government's goal of a reserve of $300 million, or about half a year's imports.

15. The monetary authorities continue to keep inflation under control. Prices remained stable and the cost of living increased at an annual rate of only 1½% during 1959 and the first half of 1960, compared with 3% in 1958 and higher rates in earlier years. In 1959 the money supply grew by 10%, about the same rate as national production, as against 15% in 1958 and an average of more than 20% in 1954-1956. The Government's restraint in borrowing from the banks has made a major contribution to this stability.

16. One of the goals which the Government is still struggling to attain is the channelling of a larger share of additional resources into productive investment by encouraging private savings and by allotting a greater share of its income to the development budget. Public consumption expenditures rose by about 15% in 1959 and private consumption expenditures by 10-11%. This did not allow a satisfactory increase in savings and the Finance Minister has stated that he may be compelled to institute a higher rate of taxation on individuals or some method of forced savings.

17. The performance of the economy in 1959 and 1960 does not substantially change the conclusions of the economic report, though the prospects of achieving the Government's goals in 1964 can be said to have improved. Given internal price stability and success from the measures that are being taken to increase private savings and attract foreign investment, Israel should be able to offset the loss in some of her net receipts of foreign capital and at the same time provide for the growing import needs of the economy.

Prospects of Fulfillment of Obligations

18. At the end of 1959 the external debt of Israel totalled $618 million, of which $360 million (58%) was in the form of Independence and Development Bonds, $102 million in loans from the Export Import Bank and $156 million in suppliers' credits and other short-term loans. Debt service in 1960 will amount to $110 million, or about 17% of all foreign exchange receipts in 1959. About 80% of total service in 1960 is for suppliers' credits. Though service on such debts drops off steeply, Israel will continue to incur new suppliers' credits though it is likely that she will keep them to manageable proportions.

19. The most unpredictable feature of Israel's external debt is the sale and redemption of Independence and Development Bonds. Sales of these Bonds are holding up extremely well and they have averaged $50 million per annum in recent years. Even more important to Israel is the fact that an increasing amount of these Bonds are being redeemed by holders for tourist expenditures and investment in Israel. In 1959 $19 million of this debt was redeemed for these purposes. With the setting up of Investment Information Centers in the principal towns of the United States, Israel hopes to increase foreign private investment significantly in the future.

20. If no allowance is made for future sales of Bonds or redemptions in Israeli currency, service on the Independence and Development Bonds now issued would average about $60 million from 1963-1969. Given, however, the success which has attended the efforts of Israel in the past, it seems that the burden of debt repayment on these Bonds in these years can be much reduced. By continuing to narrow the gap between payments for imports and the country's own foreign exchange earnings, Israel should be able gradually to strengthen her position, although she is unlikely to be able to do without foreign assistance for many years to come. Taking into account the above, and the special arrangements to service the proposed loan (see paragraph 5(a) above), Israel should have no difficulty in making the payments.

PART V - COMPLIANCE WITH ARTICLES OF AGREEMENT

21. I am satisfied that the proposed loan complies with the requirements of the Articles of Agreement of the Bank.

PART VI - RECOMMENDATIONS

22. I recommend that the Bank make a loan to Israel in an amount in various currencies equivalent to $27.5 million for a term of 25 years at an interest rate of 5.3/4 % per annum and on such other terms as are specified in the draft Loan Agreement attached, and that the Executive Directors adopt a resolution to that effect in the form attached (No.7).

Washington, D.C.
August 25, 1960

W. A. B. Iliff
Vice President

for Eugene R. Black
President